IMPERIAL TOBACCO COMPANY OF CANADA, LIMITED

ANNUAL REPORT 1965

THE YEAR AT A GLANCE

CONSOLIDATED NET EARNINGS		
amount for year		$13,331,000
compared to previous year — increase		1,825,000
INCOME TAXES		
amount for year		12,460,000
compared to previous year — increase		1,695,000
EARNINGS PER COMMON SHARE		
amount for year		1.34
compared to previous year — increase		.19
DEBENTURES		
amount at beginning of year		7,035,000
decrease during year:		
maturing 15th April 1966	$1,789,000	
purchased and cancelled	2,984,000	4,773,000
amount at end of year		2,262,000
RETAINED EARNINGS		
amount at beginning of year		45,570,000
added during year		2,312,000
amount at end of year		47,882,000
WORKING CAPITAL		
amount at beginning of year		93,604,000
decrease during year		6,183,000
amount at end of year		87,421,000
DIVIDENDS		
amount for year on		
6% cumulative preference shares		413,000
common shares (rate per share 80¢)		7,736,000
all shares		8,149,000

The figures set out on this page provide a quick glance at the results for the year 1965. More comprehensive information appears on pages 16 to 24.

IMPERIAL TOBACCO COMPANY OF CANADA, LIMITED

FIFTY-FOURTH ANNUAL REPORT 1965

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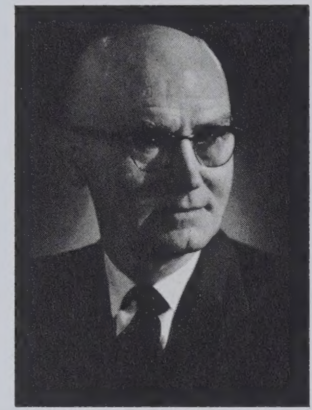
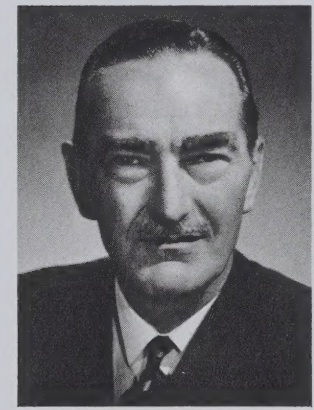


JOHN M. KEITH
president



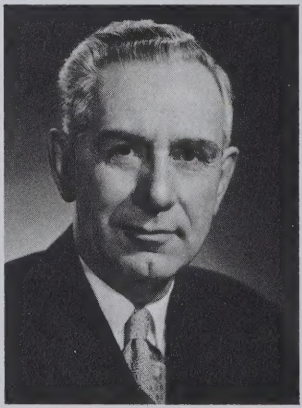
J. A. CALDER
executive vice-president

BERNARD DANSEREAU
Q.C., *general counsel*

T. E. R. HAWKINS
organization and personnel

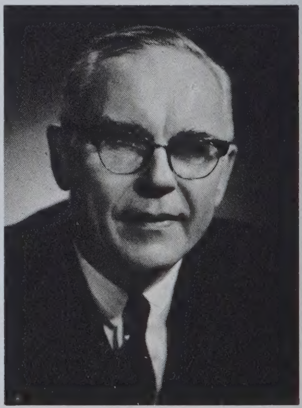
D. E. KEARNEY
vice-president — leaf tobacco

R. B. B. LANSDOWN
vice-president — manufacturing



LEO C. LAPORTE
vice-president
— research and development

PAUL PARÉ
vice-president — marketing



A. R. TILLEY
vice-president and secretary

W. H. BOOTH, *treasurer*
R. A. HILLHOUSE, *comptroller*
M. G. GLEZOS, *assistant treasurer*
L. W. GRIFFITHS, *assistant treasurer*
PIERRE ROBERGE, *assistant secretary*

DELOITTE, PLENDER, HASKINS & SELLS, *auditors*
TOUCHE, ROSS, BAILEY & SMART, *accounting consultants*

COMPANY SCORES STRONG ADVANCES

An upturn in Imperial Tobacco's business was achieved during 1965 with total sales of $366,262,000 advancing $14,806,000 over 1964 and net earnings of $13,331,000 being 16 per cent ahead of 1964. Dividends on common shares for the year were 80 cents per share, which represented an increase of 7½ cents per share over the total dividends paid for each of the four previous years. This was the 54th year in which the Company has paid dividends consecutively without interruption, a record of performance held by very few companies in North America.

As in the case of the tobacco industry as a whole, the Company's increase in dollar sales during the year was made up in part by an increase in the volume of cigarettes, and in part by the effect of the price increase on cigarettes for the full year following its introduction in the last quarter of 1964.

The improvement in earnings, however, may be short-lived because of the sharp rise in cost of leaf tobacco for the 1965 crop and the effect of a further round of wage increases.

The Company signed an important three-year agreement with the Tobacco Workers' International Union covering some 3,300 employees in seven plants of the Company and its affiliates. The agreement provides a general wage increase spread over three years and also a reduction in the hours of the work week with no loss of wages. This shorter work week is well below the average of other manufacturing industries.

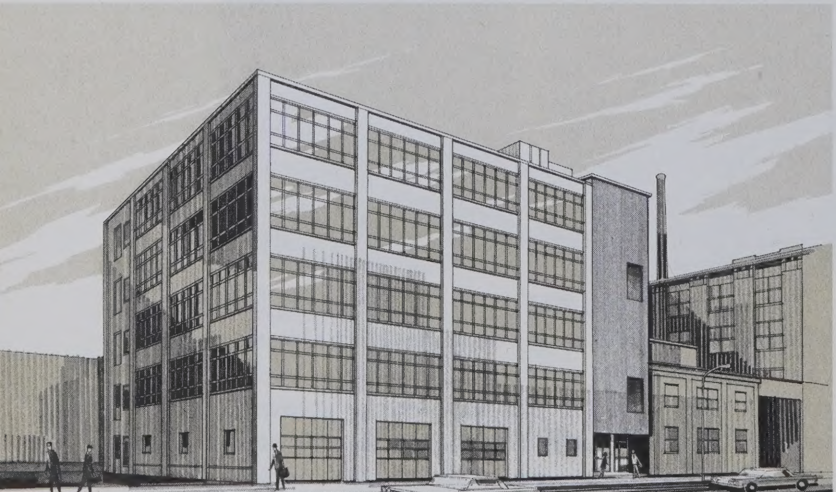
A feature of significance in the agreement was a provision for establishment of a joint committee to study means of minimizing the effects on employees of technological improvements. This represents a progressive formula in the field of labor-management relations. In addition to this step to cushion the effects of such changes on the work force, the Company also undertook to set up a training program offering employees a variety of ways to improve their skills — apprenticeship for skilled trades, training for technological improvements, training for upgrading, and educational assistance to increase formal education.

The price of the 1965 crop of flue-cured leaf tobacco, almost entirely grown in southern Ontario, rose significantly as a result of persistent buying pressure from both domestic and overseas accounts, seriously upsetting the price structure for this basic material. In addition, some domestic and overseas buyers were unable to satisfy their needs in Canada because of the lack of supply.

A modest increase in acreage for the 1965 season had been allotted by the Ontario Flue-Cured Tobacco Growers' Marketing Board. This resulted in some 20,000,000 pounds more than the 1964 Ontario crop of 137,000,000 pounds, which had been the smallest crop in 12 years. A reduction amounting to 50% in allotted acreage had been applied by the Marketing Board in the spring of 1964.

With the 1965 yield well short of demand, the Marketing Board is expected to restore for 1966 more of this acreage. The Company hopes that Canadian tobacco growers will be able to satisfy all domestic needs and take advantage of all the export potential available. In the province of Quebec, a sharp frost in August reduced a potential record crop of 7,000,000 pounds to an actual yield of just over 4,000,000 pounds.

Imperial Tobacco's extensive research and development activities, unique in the tobacco industry in Canada, will be enlarged and integrated in the Research and Development Centre under construction, at a cost of $1,600,000. During 1965 a record number of research projects was underway as outlined in the special report on "Enterprise" that begins on page 9.



The price-cost squeeze is a matter of deep concern to the Company's management and every practical measure for improving productivity is earnestly searched out and implemented. Nonetheless, the question of a further price increase in cigarettes may have to be faced before the current year is over.

The burden the smoker has to carry is, however, affected in far greater degree by the onerous federal excise taxes on tobacco products. For instance, the federal tax on a package of 20 cigarettes amounts to 20 cents, which is practically *twice* the amount the Company receives for making the cigarettes, with all its costs for wages, salaries, leaf tobacco, supplies, plant investment, overhead — and return on investment. In addition to the impact of the federal taxes, provincial taxes add to the disproportionate load.

King-size cigarettes were most active in the market with many of the long-popular brands now available in this length. A principal objective of Imperial Tobacco has been to ensure adequate representation and the Company now enjoys more than 50% of this market. The trend toward filter cigarettes continues but at a slower rate than in previous years.

Peter Jackson Tobacco Sales Limited, an Imperial marketing company, registered an increase in sales beyond the industry average, primarily through its du Maurier brand, the popular filter cigarette, and its Peter Jackson brand, which continued to show growth in volume during the year.

Among the activities of Imperial Tobacco Sales Limited, another Imperial marketing organization, the Player's family of brands as a whole improved its volume in 1965 with a strong program of pro-

gressive marketing efforts. The promotion of new Player's Kings, a filter cigarette, was possibly the most extensive ever mounted for a new cigarette launching in Canada.

The widespread popularity of sports car racing has provided a significant means of promotion for the brand with such key racing events as the "Player's 200" at Mosport, Ontario, and the "Player's Quebec" at St. Jovite in the Laurentians. The "Player's Pacific" was again an outstanding trophy race in Vancouver; and for the Prairies region a Player's trophy was up for competition for the first time. In relation to these events an extensive series of fashion shows featured the Player's Kings diagonal blue-and-white design as portrayed on the cover, and a number of sportswear manufacturers have used this design in their lines.

Among other promotions, Matinée cigarettes in king-size, previously on sale in British Columbia and Newfoundland, were introduced in Manitoba and Saskatchewan late in the year with a vigorous program. The early results are most encouraging.

As in other industries, much activity was seen during 1965 in the tobacco industry with the use of a variety of incentives, contests, gifts and coupons. The Company has participated in a number of such activities.

The market for mentholated cigarettes registered a good gain and Cameo retained its strong position as the leader in this field, with more than three times the sale of any other mentholated cigarette.

While the sale of plain-end cigarettes continues to decrease gradually, most of the brands hold a substantial loyalty, with Player's Mild the leader in this segment. The long-established Sweet Caporal and Buckingham brands similarly maintain their particular appeal.

Experimental growing of cigar-wrapper leaf was increased in 1965 on the Company's Practical Experimental Farm in southern Ontario. At present all wrapper leaf must be imported by Canadian cigar manufacturers. The 18-acre area, covered by a cotton "tent", presented an unusual spectacle this past summer. This shade-growing technique is required to provide the right balance of heat and moisture.

A new Sweet Caporal King, with a charcoal filter, was introduced in Manitoba experimentally during the year. However, the experience of the industry to date suggests that charcoal filters have not yet gained acceptance in Canada, nor elsewhere, to any appreciable degree.

General Cigar Company, Limited, the cigar manufacturing subsidiary of Imperial Tobacco, had a good year in sales volume. The sales of General Cigar account for about 50 per cent of the cigar business in Canada. A feature was the further development of the cigarillo market with Old Port

John Surtees, international sports car racing champion, is presented the "Player's Quebec" trophy following his victory at St. Jovite in the Laurentians by John M. Keith, president of Imperial Tobacco. Monique Plourde, Miss Player's, looks on approvingly.

cigarillo achieving spectacular growth in sales, more than twice the volume of any other cigarillo in Canada. With Old Port Straights, this family of brands has much the largest sale in Canada and has been successfully exported to overseas markets, including Australia, Africa and the West Indies.

The new character of the White Owl cigar in its Corona Mild form was further developed with the entry of White Owl Slim 'n Mild and Tipped Mild.

The House of Lords group again maintained its position as the leader among the higher-priced cigars while the La Palina and Reas Candella brands were further developed in their markets. Marguerite, an important cigar on the market, benefited from a striking new package.

A significant innovation should yield worthwhile benefits to the Company with the sale of the famous Tiparillo by Robt. Burns of the United States in Canada, and the sale of Old Port cigarillo in the United States. A reciprocal arrangement to this effect was made with General Cigar Co., Inc., of the United States (not related to General Cigar Company, Limited of Canada). Manufacturing and marketing plans in both countries were developed during the year, with some preliminary, and successful, sale of Tiparillo in Canada before year-end.

The continuing pressures of higher wages and raw material costs led to a decision late in 1965 by General Cigar in Canada to increase the price of cigars to wholesalers effective January 1, 1966. Improvements in technology and productivity had made possible holding the line for many years — the last previous price increase in the cigar industry had been in 1949 — but costs finally outstripped economies to the extent of requiring some price adjustment.

In pipe tobaccos the pattern of growth in the industry during the last few years levelled off during 1965. The Dutch tobaccos have secured a substantial portion of this market and the Company's Hollandia brand is doing well. Hollandia Aromatic was introduced in 1965 and will be receiving national distribution in 1966, which should contribute to this brand's share of the market. As well, market tests of the new Old Port pipe tobacco are being

conducted. Old Chum, long a popular domestic pipe tobacco, continued to hold its share of business.

The market for fine-cut tobaccos continued to decline as fewer smokers "roll-their-own". Player's fine cut and Vogue fine cut have sizeable markets and the Company introduced Embassy fine cut in certain markets with encouraging prospects.

Although not large, the markets are steady in snuff, plug, twist and chewing tobaccos and the Company continues to be the principal manufacturer of these products in Canada.

A wide variety of advertising programs in almost all media supported these diverse sales efforts. Of interest is the participation of the Company in the sponsorship of such television spectaculars as the Julie Andrews Show for du Maurier and the James Bond Special for Noblesse cigarettes.

The Company's attention to research and development has been unique in the industry in Canada for many years, as outlined in further detail in the section on "Enterprise" that follows. The experimental growing of shade-grown cigar-wrapper leaf on the Company's Practical Experimental Farm was extended to an 18-acre area in 1965 compared with a half-acre plot in 1964. Work on construction of the enlarged research and development centre in Montreal also advanced.

During 1964 and 1965 Imperial Tobacco participated in retaining the firm of P. S. Ross and Partners as consultants to study the distributive system in practice in the industry. The consultants found that in some areas there were too many wholesalers to permit all to conduct efficient and profitable operations. After an exhaustive analysis, the Company decided to embark on a program of reducing the number of its wholesalers and direct retail accounts across Canada in the course of the next few years. A new department of distributive services has been formed to counsel and assist those affected.

As reported in last year's Annual Report, effective control of Canada Foils, Limited, the founder of the foil industry in Canada, had been acquired in 1964. During the past year the Company acquired additional shares and in November offered to purchase all publicly held Class "A" and Common shares of Canada Foils. The response to this offer was very satisfactory and at the time of going to press in February 1966, Imperial Tobacco was the owner of virtually all of both categories of shares. During the year further purchases of shares of Growers' Wine Company Limited were made and Imperial Tobacco now owns a majority of the shares. Progress in respect to both of these companies is reported in greater detail in the special section on "Enterprise" that follows.

In matters relating to smoking and health, the Company continues to cooperate with the federal Department of National Health and Welfare and other interested organizations. The importance of independent medical and scientific research cannot be over-emphasized and money is available for work in this field from the Canadian tobacco industry research fund.

Increased efforts were made during the year in corporate communications. To broaden background and heighten interest of employees, more information was circulated internally, and toward the end of the year an employee publication, "The Leaflet", in English and French editions, was introduced as a means of regular and uniform communication to all levels of employees. The Company's activity in external communications was also increased and information was issued from time to time as considered relevant. Senior officials of the Company

accepted an increasing number of speaking engagements before a variety of groups and associations.

Imperial Tobacco has taken keen interest in Centennial observances and in Expo 67. The Company has joined with other major manufacturers of the tobacco industry to sponsor "Sun Acre", focal point of the theme exhibit "Man the Provider". The "Sun Acre" will be a restful, park-like area at the centre of the eight-acre agricultural complex and will illustrate the basic cycle of growth.

Plans for a stimulating, non-commercial undertaking by the Company in support of Canada's Centennial are also well advanced and will be announced shortly.

The drive and dedication shown by employees during 1965 have yielded tangible results and reflect the intensive internal reorganization work of recent years. The Board of Directors is fully appreciative of the loyalty, enthusiasm and efficiency displayed by the employees in all parts of the Company.

The strengths of Imperial Tobacco as the only company in Canada fully diversified in the tobacco business are increasingly evident, as elaborated in the special section that follows. The Company anticipates continued satisfactory progress and looks forward to another year of improved sales and, hopefully, improved earnings.

On behalf of the Board of Directors,

John M. Keith

President

Montreal, 21 February 1966.

With nearly 200 retail outlets across Canada, the United Cigar Stores chain, a subsidiary of Imperial Tobacco, reflects the Company's diversified enterprise in all stages of the tobacco industry. Frank P. Shaw, left, president of United Cigar Stores, discusses affairs with Rod Matheson, district sales manager, in front of the U.C.S. store at Yorkdale shopping centre in suburban Toronto.

ENTERPRISE

WHAT is enterprise?

Among the dictionary definitions are several interpretations: "Energy and initiative"; "Readiness to take risks or try something untried"; and even "A bold, hard, dangerous, or important undertaking."

The sense of enterprise is frequently evident enough among certain individuals or small organizations, but is not always recognized as an essential ingredient in large corporations. In this day and age virtually no business, regardless of size, can take its earnings for granted. Strenuous and energetic performance must be the order of the day.

In its 54 years of corporate history Imperial Tobacco Company of Canada, Limited has pioneered in countless aspects of the tobacco industry — to the extent that it is the only company fully diversified in all stages of the industry in Canada, from purchase of the tobacco leaf, through processing of the leaf, to all stages of manufacture and marketing of products.

A single example of the Company's early enterprise that had far-reaching impact on the growth of the Canadian economy took place soon after the incorporation of Imperial Tobacco in 1912 when the Company built 23 curing barns or kilns for nine growers in Ontario near Lake Erie's "sun-parlour". These growers produced Canada's first "cash crop" of Virginia flue-cured tobacco. Imperial Tobacco guaranteed the growers the sale of all these crops in advance, and sold the kilns to the growers at a reduced price. The Company in the ensuing 15 years systematically brought to Canada many top experts in tobacco culture and curing. A continuing Company interest has been taken in leaf tobacco growing in Ontario, Quebec and in recent years in the Maritimes, wherever possibilities have been found for potentially satisfying returns for growers.

In 1965, 160 million pounds of flue-cured leaf tobacco brought good livelihoods to some thousands of tobacco growers and their families and contributed

This picturesque vineyard in the Okanagan Valley of British Columbia is an important supplier of grapes for Growers' Wine Company Limited in which Imperial Tobacco owns the majority of shares. Aggressive marketing innovations are enhancing the successful results that Growers' Wine has enjoyed in the past.

to the prosperity of many thousands of other workers, suppliers and retailers.

Imperial Tobacco specialists and research scientists have worked closely with the growers for more than 50 years in helping them improve their agricultural practices and benefit from the Company's practical experimental farm in cooperation with the federal and various provincial Departments of Agriculture. Imperial Leaf Tobacco Company, a subsidiary of Imperial Tobacco, is by far the largest buyer of leaf tobacco for Canadian manufacturers. It also sells leaf tobacco to many countries in world markets, which is helpful to the Canadian economy.

Of Canadian tobacco manufacturers, the Company is the only one that does its own leaf buying and processing, with plants at Delhi and Aylmer in Ontario and Joliette in Quebec. In the manufacture of finished products, the Company's plant at Guelph, Ontario, not far from the leaf country, built five years ago, is still regarded as a model and the most efficient plant of its type in the world. The stream of innovations and technical improvements developed in this plant has contributed to the exchange of technology among the Company's other manufacturing units at Montreal, Quebec City, Granby and Hamilton.

The Company's manufacturing and engineering skills are continuously directed toward finding improvements, be they small or large. Many of the cigarette making machines are in the process of being modified for increased efficiency. The engineering staff converted existing machinery to use in the "slit-end fold" style of foil carton wrapping for hinge-lid packages of 20 cigarettes. In this way, they accomplished a worthwhile saving in cost, added to machine efficiency, and eliminated the separate stage of attaching an end-label on cartons, which was previously necessary.

During the year a new docking platform at Guelph was installed to provide complete enclosure for personnel, trucks, trailers and rail freight cars in the delivery of supplies and the shipment of finished goods. A new warehouse at Joliette, Quebec, was constructed for the storage of cigar leaf and incorporated a new rack system for stacking bales, a unique development which added considerably to the ease of handling and improved care of cigar leaf.

During 1965 the Company had a record number of research projects underway. Many of these

Colorful, flexible packaging materials represent one aspect of the varied lines produced for many industries in Canada and abroad by Canada Foils, Limited at its large modern plant in Toronto. Virtually all shares of the company are now owned by Imperial Tobacco.

actually reached successful culmination during the year and were put to work to achieve added efficiencies. A new automatic feeding stage for cigarette making machines has now been put into operation. An unusual "fives packer" machine was perfected which permits the automatic filling of five cigars into a pack. The prototype was installed at the General Cigar Company plant in Montreal and represents a cost per machine of one-fifth of the former equipment, and also represents a new item of Canadian manufacture as against one previously imported.

These are a few examples of the work going on in Imperial Tobacco that give meaning to the word "enterprise". A stimulus to this kind of research activity was provided by significant new federal legislation in 1962 in respect to added depreciation allowances for approved research projects. The Company has made full use of this helpful legislation with valuable benefits to its own operations, and added use of Canadian materials and Canadian suppliers.

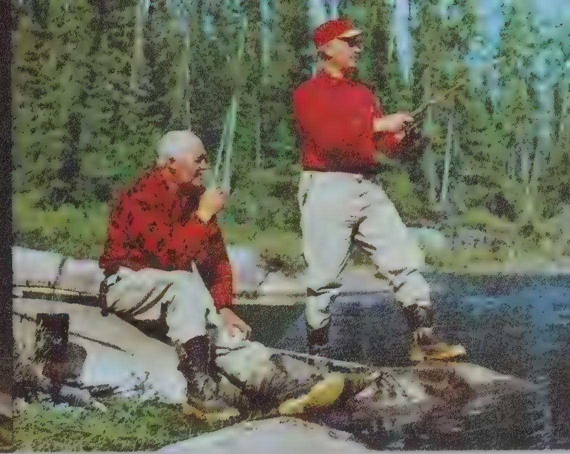
Construction of the new Research and Development Centre, referred to in last year's Annual Report, is underway and should be completed during 1966. This integration and expansion of laboratory and engineering facilities, at a cost of some $1,600,000, puts the Company's activity in this respect still further ahead in the industry in Canada and well maintains its position as one of the most advanced tobacco research centres in the world.

These examples of ongoing physical improvements are paralleled by the incessant search for improved effectiveness in all other Company functions. During the year a program was developed to take advantage of more advanced computer equipment. New methods were introduced in purchasing, in stock planning, and in physical distribution. New techniques were applied in the training and development of staff. The critical path planning technique, mentioned last year, was put to increasingly effective use. Comprehensive orientation workshops gave all the sales force valuable Company background and renewed incentive for their daily work. In short, all aspects of internal organization of Imperial Tobacco are being made increasingly "fighting fit".

During the year a new security division was established to safeguard company property. One of its early activities was to assist truckers, particularly in the Province of Quebec, against highway hi-jacking in which costly robberies of cigarettes were being sustained. By introducing a system of armed guards to accompany trucks, this hazard was largely eliminated. Action was also initiated to secure an amendment to the Quebec Civil Code which, at present under certain circumstances, does not assign responsibility, as in other provinces, to carriers for the safety of the goods entrusted to them in transit.

Among the Company's subsidiary and associated activities is that of the United Cigar Stores Limited, wholly owned by Imperial Tobacco. This chain of retail outlets operates some 200 stores across

where the action is...




House of Lords
PETIT CORONAS
25
REAS
PETIT CORONAS
ALL HAVANA
Light Candella
MARGUERITE
OLD PORT
EXTRA MILD
OLD PORT
STRAIGHTS
OLD PORT
OLD PORT
CIGARILLOS
Corona Mild
WO
White Owl
Tiparillo
by Robt. Burns
OLD PORT
PIPE TOBACCO
EXTRA MILD
OLD CHUM
AROMATIC
LOUIS DOBBELMANN HOLLAND
Hollandia
Hollandia

Canada, of which 60 are located in shopping centres. Many others have space in the new skyscrapers and command the most central locations in the larger metropolitan areas in Canada. While their sales of tobacco products are an important part of their total volume, through the years a widening range of other merchandise has enhanced their growth and has helped to serve particular needs for large numbers of customers. The stores pride themselves on the friendly personal service provided by their staffs.

The spirit of enterprise in Imperial Tobacco is also being applied with diligence in the diversification interests acquired during 1964. Reference has already been made to Canada Foils, Limited in the President's Report on page 7. This company, manufacturers of aluminum foil and the first and largest converter in Canada, also produces a wide range of flexible packaging materials. It is equipped to multi-color print in rolls or sheets by rotogravure, flexographic and letterpress methods, in addition to lamination in roll form by wax and adhesives.

Canada Foils has just installed a new polyethylene extruder and coater machine. This machine embodies improvements in the technical procedures of extruding polyethylene not only to foil but to transparent films, paper and other materials.

While Canada Foils has been an important

Imperial Tobacco and General Cigar Co., Inc., of the United States entered into a reciprocal arrangement in 1965 to manufacture and sell each other's leading cigarillo. In Canada the famous Tiparillo by Robt. Burns is now entering the market and in the United States the Old Port cigarillo will be launched shortly. In this photo, discussing marketing plans, are, from left: J. H. Vaamonde, Young & Rubicam, New York; George Reichart, General Cigar Co., Inc., U.S.A.; Paul Paré, vice-president, Imperial Tobacco; Peter Thomson, product manager, and R. B. Alexander, vice-president, General Cigar Company, Limited of Canada; and Milton Freedland, General Cigar Co., Inc., U.S.A.

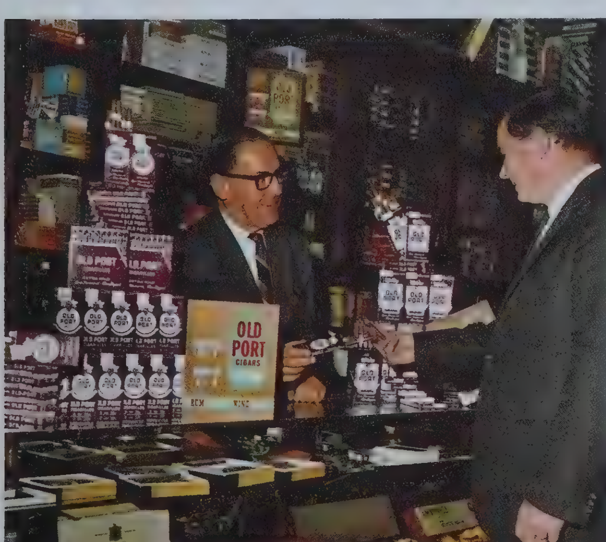
supplier of packaging materials to Imperial Tobacco for many years, the almost countless items it produces for modern day living range from foil for food trays to burglar alarm foil, from candy bar wrappers to frozen food pouches. The design of many of these products is created by the company's own art studio.

Growers' Wine Company Limited, in which Imperial Tobacco owns the majority of shares, is a thriving organization in British Columbia. The management of Growers' Wine has been engaged in the first phase of reorganization of its marketing presentation which has already shown results in increased sales for its three major families of wines — Ste. Michelle, Beau Séjour and Vali Vinta. Among other products of Growers' Wine is a popular cider which is packed in convenient containers for easy carrying. The plans of Growers' Wine augur well for enlarging its market and for improved earnings.

In Ontario, Imperial Tobacco had acquired an interest in 1964 in Welland Winery Limited, which had been in business in a small way for many years. During 1965 plans were well advanced for increased activity in the Ontario market.

Imperial Tobacco is maintaining a continuing and systematic examination of situations in which its experience and skills can be applied toward securing returns that are commensurate with the investment and effort expended.

As already pointed out, Imperial Tobacco is the only company that is fully diversified within the tobacco business in Canada. The Company's depth of knowledge and experience extends from the planting of the tobacco leaf seed through all stages of growing and processing, manufacturing and marketing. The related activities and structures in the tobacco industry have been developed by the Company to take full advantage of its know-how in the industry. This same philosophy is applied in its approach to new undertakings in the true spirit of enterprise.



The Old Port family of cigars, already enjoying the largest sale of cigars in Canada, is being exported to an increasing number of countries. Here a tobacconist in Melbourne, Australia, gives the brand feature display.

COMMENTS ON THE YEAR'S OPERATIONS

CONSOLIDATED sales in 1965 at $366,262,000 were 4% higher than the previous year. Increased volume and a full year's benefit from the September 1964 price increase of cigarettes both contributed to this improvement.

Net earnings at $13,331,000, an increase of 16%, reflected the improved sales, offset in part by higher costs for wages and employee benefits and for leaf tobacco, and in part by the lower margin available on proportionately higher sales of king-size cigarettes. After dividends on outstanding 6% cumulative preference shares, earnings per common share were $1.34, compared with $1.15 in 1964.

Regular dividends were paid during the year on outstanding 6% cumulative preference shares. Three interim dividends of 15¢ each and one of 17½¢, totalling 62½¢, were paid per common share. A final dividend for 1965 of 17½¢ per common share has been declared payable 31st March 1966, making total dividends of 80¢ per common share for the year 1965, an increase of 7½¢ per share over the amount of total dividends paid for each of the four previous years.

A transfer of $3,011,000 was made at year-end from retained earnings to accumulated depreciation as a result of the increase in replacement cost of fixed assets. The principal factors contributing to the increase in replacement values were higher costs of construction, higher prices of equipment and the increase from 8% to 11% in federal sales tax applicable to production facilities which became effective 1st January 1965. It is considered prudent and proper to recognize and reflect the effects of such factual cost changes.

A charge of $74,000 was made to retained earnings for the premium, brokerage and tax on 42,405 of the 6% cumulative preference shares purchased and cancelled during the year. A transfer of $207,000 from retained earnings to capital surplus resulted from this operation which brought total capital surplus arising from the cancellation of 6% cumulative preference shares to $1,264,000 at year-end pending future application being made and approved for proportionate reduction of capital.

Retained earnings at $47,882,000 at the end of 1965 showed an increase of $2,312,000 for the year. This increase was the combined net result of the previously mentioned reductions totalling $3,292,000, a further reduction of $322,000 for the write-off of goodwill arising from the acquisition of a new consolidated subsidiary and additions of $5,182,000 for the excess of net earnings over dividends and $744,000 for the net effect of disposal of fixed assets.

Working capital at $87,421,000 at the end of 1965 showed a decrease for the year of $6,183,000 after taking into account more than $17,000,000 for increased investments, debentures redeemed in advance of maturity and those maturing currently, acquisition of fixed assets, preference shares purchased for cancellation and the increase in total dividends for the year on common shares.

On 12th November 1965, Con-Pack Limited, a wholly owned subsidiary of Imperial Tobacco Company, offered to purchase all the publicly held Class "A" shares and Common shares of Canada Foils, Limited. At the time of the offer, Imperial Tobacco was the beneficial owner of 800 Class "A" shares and 53,160 Common shares of the 100,000 shares of each class issued and outstanding. At year-end, Imperial Tobacco was the beneficial owner of more than 95% of the Class "A" shares and 99% of the Common shares of Canada Foils. The favorable response led to the offer subsequently being extended to 15th March 1966 and additional shares of each class have been acquired since 31st December 1965.

In addition to the increased holdings in Canada Foils, Limited, investments in Growers' Wine Company Limited and Welland Winery Limited were increased during the year, and the total investment in these three subsidiaries at year-end, including loans and advances, was $13,077,000. Their financial results have not been included in the consolidated accounts presented herein except to the extent of dividends received. No dividends were received in 1965 in respect of a very large number of Canada Foils shares acquired after the November dividend record date. The timing of these purchases also materially affected the proportion of 1965 net earnings of non-consolidated subsidiaries reported in Note 1.

Following declaration of the final dividend on common shares for 1965, the first interim dividend for 1966 of 17½¢ per common share was declared payable 31st March 1966. This equals the interim rate established when the December 1965 interim was increased from 15¢ per share paid previously with a view to increasing the proportion of the total distribution payable in the form of interims during the course of the year.

CONSOLIDATED EARNINGS (note 1)

	1965	*1964*
Net sales	$366,262,000	$351,456,000
Cost of sales, excise taxes, merchandising and general expenses (note 2)	337,475,000	325,919,000
Depreciation (note 3)	4,539,000	4,243,000
	342,014,000	330,162,000
Earnings from operations	24,248,000	21,294,000
Income from investments in non-consolidated subsidiaries (note 1)	101,000	—
Income from other investments	1,638,000	1,232,000
	25,987,000	22,526,000
Interest on funded debt	196,000	255,000
Earnings before income taxes	25,791,000	22,271,000
Income taxes (note 4)	12,460,000	10,765,000
Net earnings for the year	$ 13,331,000	$ 11,506,000

CONSOLIDATED RETAINED EARNINGS (note 1)

Retained earnings 1st January	$ 45,570,000	$ 41,490,000
Net earnings for the year	13,331,000	11,506,000
Additional depreciation requirement (note 3)	*3,011,000*	*1,778,000*
Net loss on disposal of fixed assets	*148,000*	*686,000*
Capital increment applicable to disposal of fixed assets	892,000	2,793,000
Premium, brokerage and tax on 6% cumulative preference shares purchased	*74,000*	*79,000*
Transferred to capital surplus (note 10)	*207,000*	*242,000*
Write-off of goodwill arising from acquisition of a consolidated subsidiary	*322,000*	—
	56,031,000	53,004,000
Dividends (note 5)	8,149,000	7,434,000
Retained earnings 31st December	$ 47,882,000	$ 45,570,000

The notes on pages 19 and 20 form an integral part of these statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. *Principles of consolidation and related information*

The consolidated financial statements include the accounts of Imperial Tobacco Company of Canada, Limited and all subsidiary companies whose business relates to tobacco products. Subsidiary companies excluded from consolidation are those which became subsidiaries during 1965 and whose business does not relate to tobacco products. It is considered impractical at this time to consolidate these latter subsidiaries.

The financial results of non-consolidated subsidiaries have been included in the consolidated accounts only to the extent of dividends received.

In respect of non-consolidated subsidiaries, the company's proportion of (a) net earnings for fiscal periods ended in 1965 amounted to $159,000 and (b) the net increase in retained earnings since acquisition to the end of such fiscal periods amounted to $121,000.

2. *Cost of sales, excise taxes, merchandising and general expenses*

Included in this item is the amount of $380,000 (1964 — $419,000) paid in respect of remuneration to directors.

3. *Fixed assets and depreciation*

a) Depreciation charged against earnings for the year and accumulated depreciation to date are based on replacement cost both in the consolidated statements and in the books of the individual companies. The same rates applied to historic cost would have given rise to a charge for the year of $3,486,000 (1964 — $3,372,000).

b) Additional depreciation requirement of $3,011,000 (1964 — $1,778,000) in respect of prior years, arising from current year's increase in replacement cost, has been charged to retained earnings.

c) Fixed assets are recorded in the books of the companies at historic cost and are shown at replacement cost only on consolidation.

d) The replacement cost of fixed assets is based on appraisals made as at 31st December. For 1965, buildings were appraised at replacement cost and land at current market value by Canadian Appraisal Company Limited. Machinery and equipment were valued at replacement cost by company officials utilizing price indexes obtained from the Dominion Bureau of Statistics and, where necessary, price indexes based on government and industry studies in other countries. On consolidation the use of replacement cost gives rise to an increase in fixed assets before depreciation of $38,886,000 (1964 — $34,582,000) which is reflected in capital increment

e) The effects of the foregoing are summarized as follows:	*1965*	*1964*
Land, buildings and equipment at historic cost	$ 67,076,000	$64,928,000
Capital increment	38,886,000	34,582,000
Replacement cost	105,962,000	99,510,000
Less:		
Accumulated depreciation 1st January	55,880,000	53,409,000
Accumulated depreciation on disposals during year	*1,525,000*	*3,550,000*
Depreciation for the year	4,539,000	4,243,000
Additional depreciation requirement transferred from retained earnings	3,011,000	1,778,000
Accumulated depreciation based on replacement cost	61,905,000	55,880,000
Fixed assets	$ 44,057,000	$43,630,000

4. *Income taxes*

The amount payable exceeds the charge for income taxes by $101,000 (1964 — the reverse by $5,000) as a consequence of allowable depreciation being less (1964 — more) than the amount charged in the accounts. The balance sheet item termed "Accumulated income tax reductions applicable to future years" has been reduced (1964 — increased) by the amount concerned, and net adjustments arising from revised allowable depreciation applicable to prior years are also reflected in the total decrease of $93,000 (1964 — $97,000) in this item for the year.

1965	*1964*
,263,000	$ 13,165,000
,122,000	13,100,000
,849,000	14,889,000
,179,000	82,474,000
,413,000	123,628,000
,331,000	6,924,000
,079,000	21,087,000
,793,000	1,313,000
—	700,000
,789,000	—
,992,000	30,024,000
,421,000	93,604,000
786,000	—
,291,000	—
,061,000	6,548,000
,057,000	43,630,000
,282,000	1,366,000
1,000	1,000
,899,000	145,149,000
,262,000	7,035,000
,486,000	1,579,000
,748,000	8,614,000
,151,000	$136,535,000
,119,000	55,326,000
,886,000	34,582,000
,264,000	1,057,000
,882,000	45,570,000
,151,000	$136,535,000

Approved by the Board:
John M. Keith, Director
J. A. Calder, Director

CONSOLIDATED EARNINGS

Net sales

Cost of sales, excise taxes, n
Depreciation (note 3)

Earnings from operations
Income from investments in
Income from other investmei

Interest on funded debt

Earnings before income taxe
Income taxes (note 4)

Net earnings for the year

CONSOLIDATED RETAINED

Retained earnings 1st Januar
Net earnings for the year
Additional depreciation requi
Net loss on disposal of fixed
Capital increment applicable
Premium, brokerage and tax
Transferred to capital surplu
Write-off of goodwill arising

Dividends (note 5)

Retained earnings 31st Decer

The notes on pages 19 and 20 for

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

5. *Dividends*

	1965	*1964*
Dividends of Imperial Tobacco Company of Canada, Limited:		
On 6% cumulative preference shares	$ 413,000	$ 423,000
On common shares:		
Four interim dividends totalling 62½ cents per share (1964 — 60 cents)	6,044,000	5,802,000
Provision for final dividend for year of 17½ cents per share (1964 — 12½ cents)	1,692,000	1,209,000
	$ 8,149,000	$ 7,434,000

6. *Provision for dividends*

Provision for dividends of Imperial Tobacco Company of Canada, Limited:

	1965	*1964*
Accrued on preference shares	$ 101,000	$ 104,000
Final for year on common shares	1,692,000	1,209,000
	$ 1,793,000	$ 1,313,000

7. *Investments in non-consolidated subsidiaries*

Investments in non-consolidated subsidiaries, stated at cost, include shares totalling $5,642,000 which were acquired prior to 1965 in respect of companies which became subsidiaries during the year. This amount is included in "Other investments" in comparative figures for 1964.

8. *Debentures*	*1965*	*1964*
2⅞% debentures (maturing 15th April 1966)	$ —	$ 2,098,000
3% sinking fund debentures (maturing 1st March 1970)	2,262,000	4,937,000
	$ 2,262,000	$ 7,035,000

9. *Paid up share capital*		*1965*	*1964*
6% cumulative preference shares par value $4.86⅔ each			
Authorized and issued	1,650,000 shares		
Less purchased and cancelled: as at 31st December 1964	217,222 shares		
	1,432,778 shares		$ 6,973,000
during 1965	42,405 shares		
Outstanding 31st December 1965	1,390,373 shares	$ 6,766,000	
Redeemable sinking fund preference shares par value $25 each			
Authorized: 200,000 shares			
Issued: None		—	—
Common shares no par value			
Authorized: 10,800,000 shares			
Issued: 9,670,532 shares		48,353,000	48,353,000
		$55,119,000	$55,326,000

10. *Capital surplus*

The sum of $207,000 (1964 — $242,000) has been transferred from retained earnings and designated as capital surplus arising from cancellation of 42,405 (1964 — 49,781) 6% cumulative preference shares par value $4.86⅔ each.

11. *Trusteed pension plan*

Outstanding commitments in respect of funding of back service of employees under a trusteed pension plan amount to $4,615,000 at 31st December 1965 (1964 — $5,005,000) payable in annual instalments to 1981. The 1965 instalment was $390,000 (1964 — $390,000).

IMPERIAL TOBACCO COMPANY OF CANADA, LIMITED and Subsidiary Companies
31st December 1965 with comparative figures for 1964

CONSOLIDATED BALANCE SHEET (note 1)

	1965	1964
CURRENT ASSETS		
Cash and term deposits	$ 11,263,000	$ 13,165,000
Marketable securities (market value $11,146,000; 1964 — $13,112,000)	11,122,000	13,100,000
Accounts receivable less allowance for doubtful accounts	16,849,000	14,889,000
Leaf tobacco, manufacturing materials, supplies and merchandise (at average cost)	81,179,000	82,474,000
Total Current Assets	120,413,000	123,628,000
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	8,331,000	6,924,000
Income, excise and other taxes	21,079,000	21,087,000
Provision for dividends (note 6)	1,793,000	1,313,000
2¾% debentures (matured 15th April 1965)	—	700,000
2⅞% debentures (maturing 15th April 1966)	1,789,000	—
Total Current Liabilities	32,992,000	30,024,000
Working Capital (Net Current Assets)	87,421,000	93,604,000
OTHER ASSETS		
Loans and advances to non-consolidated subsidiaries	786,000	—
Investments in non-consolidated subsidiaries (note 7)	12,291,000	—
Other investments (at cost) (note 7)	1,061,000	6,548,000
Fixed assets (note 3)	44,057,000	43,630,000
Prepaid expenses and deferred charges	1,282,000	1,366,000
Goodwill, trade marks and patents (at nominal value)	1,000	1,000
	146,899,000	145,149,000
OTHER LIABILITIES		
Debentures (note 8)	2,262,000	7,035,000
Accumulated income tax reductions applicable to future years (note 4)	1,486,000	1,579,000
	3,748,000	8,614,000
Excess of Assets over Liabilities	$143,151,000	$136,535,000
Provided by:		
SHAREHOLDERS' RISK CAPITAL		
Paid up share capital (note 9)	55,119,000	55,326,000
Capital increment (note 3)	38,886,000	34,582,000
Capital surplus (note 10)	1,264,000	1,057,000
Retained earnings	47,882,000	45,570,000
	$143,151,000	$136,535,000

The notes on pages 19 and 20 form an integral part of these statements.

Approved by the Board:
JOHN M. KEITH, Director
J. A. CALDER, Director

STATISTICAL HIGHLIGHTS — TEN YEAR REVIEW

(Thousands of Dollars — except 'per common share' statistics)

	1965	1964	1963	1962	1961
SALES AND EARNINGS					
Net sales (c)	366,262	351,456	355,065	373,392	359,105
Depreciation (d)	4,539	4,243	4,050	3,757	3,482
Earnings before income taxes	25,791	22,271	23,063	25,594	26,800
Income taxes	12,460	10,765	11,049	12,233	12,943
Net earnings	13,331	11,506	12,014	13,361	13,857
Earned on common shares	12,918	11,083	11,566	12,879	13,375
Per common share	$1.34	$1.15	$1.20	$1.33	$1.38
DIVIDEND RECORD					
On preference shares	413	423	448	482	482
On common shares	7,736	7,011	7,011	7,011	7,011
Per common share	$ .80	$ .72½	$ .72½	$ .72½	$ .72½
CAPITAL EXPENDITURES					
On fixed assets	3,491	2,740	5,197	4,146	4,179
FINANCIAL POSITION					
Current assets (e)	120,413	123,628	121,537	123,127	117,590
Current liabilities	32,992	30,024	28,120	30,048	29,474
Working capital	87,421	93,604	93,417	93,079	88,116
Fixed assets (before depreciation) (f)	105,962	99,510	97,688	90,083	83,411
Fixed assets (less depreciation) (g)	44,057	43,630	44,279	42,039	40,757
Debentures (h)	2,262	7,035	8,582	9,987	11,628
Excess of assets over liabilities	143,151	136,535	130,836	125,842	118,058
SHAREHOLDERS' RISK CAPITAL					
Equity of preference shareholders	6,766	6,973	7,215	8,030	8,030
Equity of common shareholders	136,385	129,562	123,621	117,812	110,028
Per common share	$14.10	$13.40	$12.78	$12.18	$11.38

(a) 1960 revised in accordance with 1961 and subsequent years' presentation.

(b) 1956/59 revised in accordance with 1961 and subsequent years' presentation to the extent that equity reserves are included under shareholders' risk capital. Effect of replacement cost valuation of fixed assets on yearly charge for depreciation, on fixed assets, on accumulated depreciation and on equity of common shareholders and effect of write down of goodwill not reflected.

(c) Not published for years previous to 1960.

STATISTICAL HIGHLIGHTS – TEN YEAR REVIEW

(Thousands of Dollars — except 'per common share' statistics)

1960(a)	1959(b)	1958(b)	1957(b)	1956(b)	
					SALES AND EARNINGS
342,775	—	—	—	—	(c) Net sales
3,402	4,332	3,871	3,334	2,985	(d) Depreciation
26,177	24,222	21,481	22,595	21,992	Earnings before income taxes
12,557	13,111	10,816	11,641	11,522	Income taxes
13,620	11,111	10,665	10,954	10,470	Net earnings
13,138	10,629	10,183	10,472	9,989	Earned on common shares
$1.36	$1.10	$1.05	$1.08	$1.03	Per common share
					DIVIDEND RECORD
482	482	482	482	482	On preference shares
6,527	6,527	6,527	6,527	6,286	On common shares
$ .67½	$ .67½	$ .67½	$ .67½	$ .65	Per common share
					CAPITAL EXPENDITURES
5,645	8,560	8,581	7,787	4,494	On fixed assets
					FINANCIAL POSITION
112,503	108,487	105,731	102,676	130,044	(e) Current assets
30,069	34,174	31,069	27,134	53,594	Current liabilities
82,434	74,313	74,662	75,542	76,450	Working capital
82,788	54,105	46,927	39,160	32,656	(f) Fixed assets (before depreciation)
41,649	16,628	12,769	8,485	4,501	(g) Fixed assets (less depreciation)
12,796	14,056	15,177	16,217	18,190	(h) Debentures
108,992	108,963	104,135	99,686	94,691	Excess of assets over liabilities
					SHAREHOLDERS' RISK CAPITAL
8,030	8,030	8,030	8,030	8,030	Equity of preference shareholders
100,962	100,933	96,105	91,656	86,661	Equity of common shareholders
$10.44	$10.44	$9.94	$9.48	$8.96	Per common share

(d) 1960/65 based on replacement cost; 1956/59 based on historic cost and including charge for fixed asset replacement.
(e) 1960/62 revised to exclude prepaid expenses and deferred charges.
(f) 1960/65 based on replacement cost; 1956/59 based on historic cost.
(g) 1960/65 net after accumulated depreciation based on replacement cost; 1956/59 net after accumulated depreciation based on historic cost and including fixed asset replacement reserve.
(h) Excluding maturities within twelve months which are reflected in current liabilities.

STATEMENT OF CHANGES IN CONSOLIDATED WORKING CAPITAL
during the year ended 31st December 1965

Increased by:		
Net earnings	$13,331,000	
Depreciation	4,539,000	
Amount realized on sale of fixed assets	562,000	
Prepaid expenses and deferred charges	84,000	$18,516,000
Decreased by:		
Expenditures on fixed assets	3,491,000	
Loans and advances to non-consolidated subsidiaries	786,000	
Investments, including those in non-consolidated subsidiaries	6,804,000	
Dividends	8,149,000	
Purchase of 6% cumulative preference shares	281,000	
Debentures redeemed in advance of maturity	2,984,000	
Debentures maturing in less than one year transferred to current liabilities	1,789,000	
Accumulated income tax reductions applicable to future years	93,000	
Cost of goodwill on acquisition of a consolidated subsidiary	322,000	24,699,000
Net decrease		6,183,000
Working capital at beginning of year		93,604,000
Working capital at end of year		$87,421,000

AUDITORS' REPORT

DELOITTE, PLENDER, HASKINS & SELLS, Chartered Accountants
Sun Life Building, Montreal

To the Shareholders
of Imperial Tobacco Company of Canada, Limited

We have examined the consolidated balance sheet of Imperial Tobacco Company of Canada, Limited and Subsidiary Companies as at 31st December 1965 and the statements of consolidated earnings and consolidated retained earnings for the year ended on that date. Our examination included a general review of the accounting procedures and such tests of the accounting records and other supporting evidence as we considered necessary in the circumstances except that in the case of certain non-consolidated subsidiary companies we have relied upon the reports of other auditors. Insofar as our opinion expressed below relates to information contained in the financial statements of those companies, it is based solely upon the reports of such other auditors.

In our opinion, the accompanying consolidated balance sheet, which incorporates the adjustment to the values of fixed assets referred to in note 3(c), and statements of consolidated earnings and consolidated retained earnings present fairly the financial position of the companies as at 31st December 1965 and the results of their operations for the year ended on that date, in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

We also examined the accompanying statement of changes in consolidated working capital during the year ended 31st December 1965 and the statistical highlights which are presented as supplementary information and, in our opinion, these statements present fairly the information shown therein.

Deloitte, Plender, Haskins & Sells

21st February 1966. Auditors.

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